SEC

OFFICE *of* INVESTOR EDUCATION *and* ADVOCACY

INVESTOR BULLETIN

Crowdfunding for Investors

The SEC's Office of Investor Education and Advocacy is issuing this Investor Bulletin to educate investors about a new investing opportunity in the form of securities-based crowdfunding.

Crowdfunding generally refers to a financing method in which money is raised through soliciting relatively small individual investments or contributions from a large number of people. Over the last few years, crowdfunding websites in the United States have proven a popular way by which to solicit charitable donations and to raise funds for artistic endeavors like films and music recordings.

Under recently adopted rules, the general public will have the opportunity to participate in the early capital raising activities of start-up and early-stage companies and businesses. ***Starting May 16, 2016, companies can use crowdfunding to offer and sell securities to the investing public.***

Can I make a crowdfunding investment?

Anyone can invest in a crowdfunding securities offering. ***Because of the risks involved with this type of investing, however, you are limited in how much you can invest during any 12-month period in these transactions.*** The limitation on how much you can invest depends on your net worth and annual income.

If ***either*** your annual income ***or*** your net worth is less than \$100,000, then during any 12-month period, you can invest up to the greater of either \$2,000 or 5% of the lesser of your annual income or net worth.

If ***both*** your annual income ***and*** your net worth are equal to or more than \$100,000, then during any 12-month period, you can invest up to 10% of annual income or net worth, whichever is lesser, but not to exceed \$100,000.

The following table provides a few examples:

Annual Income	Net Worth	Calculation	12-month Limit
\$30,000	\$105,000	greater of \$2,000 or 5% of \$30,000 (\$1,500)	\$2,000
\$150,000	\$80,000	greater of \$2,000 or 5% of \$80,000 (\$4,000)	\$4,000
\$150,000	\$100,000	10% of \$100,000 (\$10,000)	\$10,000
\$200,000	\$900,000	10% of \$200,000 (\$20,000)	\$20,000
\$1.2 million	\$2 million	10% of \$1.2 million (\$120,000) subject to cap	\$100,000

Joint calculation. You can calculate your annual income or net worth by jointly including your spouse's income or assets. It is not necessary that property be held jointly. However, if you do calculate your income or assets jointly with your spouse, each of your crowdfunding investments together cannot exceed the limit that would apply to an individual investor at that annual income or net worth level.

How do I calculate my net worth?

Calculating net worth involves adding up all your assets and subtracting all your liabilities. The resulting sum is your net worth.

For purposes of crowdfunding, the value of your primary residence is not included in your net worth calculation. In addition, any mortgage or other loan on your home does not count as a liability up to the fair market value of your home. If the loan is for more than the fair market value of your home (*i.e.,* if your mortgage is underwater), then the loan amount that is over the fair market value counts as a liability under the net worth test.

Further, any increase in the loan amount in the 60 days prior to your purchase of the securities (even if the loan amount doesn't exceed the value of the residence) will count as a liability as well. The reason for this is to prevent net worth from being artificially inflated through converting home equity into cash or other assets.

While your individual circumstances will vary, the following table sets forth examples of calculations under the net worth test in order to determine crowdfunding investment limits:

	Jane Doe	John Smith	James Lee
Primary residence (not included except for related liabilities below):			
Home value	$ 300,000	$ 300,000	$ 300,000
Mortgage	200,000	200,000	330,000
Home equity line:			
more than 60 days old	–	20,000	–
less than 60 days old	–	10,000	–
Included assets:			
Bank accounts	$ 20,000	$ 20,000	$ 20,000
401(k)/IRA accounts	100,000	100,000	100,000
Other investments	50,000	50,000	50,000
Car	20,000	20,000	20,000
Total included assets	**$ 190,000**	**$ 190,000**	**$ 190,000**
Included liabilities:			
Student and car loans	$ 100,000	$ 100,000	$ 100,000
Other liabilities	20,000	20,000	20,000
Portion of mortgage underwater	–	–	30,000
Home equity line (less than 60 days old)	–	10,000	–
Total included liabilities	**$ 120,000**	**$ 130,000**	**$ 150,000**
Net worth	**$ 70,000**	**$ 60,000**	**$ 40,000**

How do I make a crowdfunding investment?

You can only invest in a crowdfunding offering through the online platform, such as a website or a mobile app, of a broker-dealer or a funding portal. Companies may not offer crowdfunding investments to you directly—they must use a broker-dealer or funding portal.

The broker-dealer or funding portal—a crowdfunding *intermediary*—must be registered with the SEC and be a member of the Financial Industry Regulatory Authority (FINRA). You can obtain information about a broker by visiting FINRA's BrokerCheck or calling FINRA's toll-free BrokerCheck hotline at (800) 289-9999. You can obtain information about a funding portal by visiting the SEC's EDGAR website.

Keep in mind that you will have to open an account with the crowdfunding intermediary—the broker-dealer or funding portal—in order to make an investment and all written communications relating to your crowdfunding investment will be electronic.

What should I keep in mind?

Crowdfunding offers investors an opportunity to participate in an early-stage venture. ***However, you should be aware that early-stage investments may involve very high risks and you should research thoroughly any offering before making an investment decision.*** You should read and fully understand the information about the company and the risks that are disclosed to you before making any investment.

The following are some risks to consider before making a crowdfunding investment:

- Speculative. Investments in startups and early-stage ventures are speculative and these enterprises often fail. Unlike an investment in a mature business where there is a track record of revenue and income, the success of a startup or early-stage venture often relies on the development of a new product or service that may or may not find a market. ***You should be able to afford and be prepared to lose your entire investment.***
- Illiquidity. ***You will be limited in your ability to resell your investment for the first year and may need to hold your investment for an indefinite period of time.*** Unlike investing in companies listed on a stock exchange where you can quickly and easily trade securities on a market, you may have to locate an interested buyer when you do seek to resell your crowdfunded investment.
- Cancellation restrictions. Once you make an investment commitment for a crowdfunding offering, you will be committed to make that investment (unless you cancel your commitment within a specified period of time). As detailed in the box below for *Changing your mind*, the ability to cancel your commitment is limited.
- Valuation and capitalization. Your crowdfunding investment may purchase an equity stake in a startup. ***Unlike listed companies that are valued publicly through market-driven stock prices, the valuation of private companies, especially startups, is difficult and you may risk overpaying for the equity stake you receive.*** In addition, there may be additional classes of equity with rights that are superior to the class of equity being sold through crowdfunding.
- Limited disclosure. The company must disclose information about the company, its business plan, the offering, and its anticipated use of proceeds, among other things. An early-stage company may be able to provide only limited information about its business plan and operations because it does not have fully developed operations or a long history to provide more disclosure. The company is also only obligated to file information annually regarding its business, including financial statements. A publicly listed

company, in contrast, is required to file annual and quarterly reports and promptly disclose certain events—continuing disclosure that you can use to evaluate the status of your investment. ***In contrast, you may have only limited continuing disclosure about your crowdfunding investment.***

- Investment in personnel. ***An early-stage investment is also an investment in the entrepreneur or management of the company.*** Being able to execute on the business plan is often an important factor in whether the business is viable and successful. You should also be aware that a portion of your investment may fund the compensation of the company's employees, including its management. You should carefully review any disclosure regarding the company's use of proceeds.
- Possibility of fraud. In light of the relative ease with which early-stage companies can raise funds through crowdfunding, it may be the case that certain opportunities turn out to be money-losing fraudulent schemes. ***As with other investments, there is no guarantee that crowdfunding investments will be immune from fraud.***
- Lack of professional guidance. Many successful companies partially attribute their early success to the guidance of professional early-stage investors (*e.g.,* angel investors and venture capital firms). These investors often negotiate for seats on the company's board of directors and play an important role through their resources, contacts and experience in assisting early-stage companies in executing on their business plans. An early-stage company primarily financed through crowdfunding may not have the benefit of such professional investors.

How do I get informed?

Broker-dealers and funding portals that operate crowdfunding platforms are required to offer educational materials to help investors understand this type of investing. These materials further detail the risks involved when making a crowdfunding investment. ***You should take advantage of this resource to educate yourself and understand the risks of making crowdfunding investments. Remember, this is your money that you are putting at risk, and you should only invest after careful consideration of the risks.***

Review and acknowledgement. Before you can make a crowdfunding investment, the broker-dealer or funding portal operating the crowd-funding platform you are using must ensure that you review educational materials about this type of investing. In addition, you will have to positively affirm that you understand that you can lose all of your investment and that you can bear such a loss. You will also have to demonstrate that you understand the risks of crowdfunded investing.

As mentioned, the companies that you invest in are required to disclose a limited amount of information to you. This information includes general information about the company, its officers and directors, a description of the business, the planned use for the money raised from the offering, often called the *use of proceeds*, the target offering amount, the deadline for the offering, related-party transactions, risks specific to the company or its business, and financial information about the company. ***You should use this information to determine whether a particular investment is appropriate for you.***

Tiered financial disclosure. The minimum level of financial disclosure required by the company depends on the amount of money being raised or raised by the company in the prior 12 months:

- **$100,000 or less**—financial statements and specific line items from income tax returns, both of which are certified by the principal executive officer of the company.
- **$100,000.01 to $500,000**—financial statements *reviewed* by an independent public accountant and the accountant's review report.
- **$500,000.01 to $1 million**—***if*** first time crowdfunding, ***then*** financial statements *reviewed* by an independent public accountant and the accountant's review report, ***otherwise*** financial statements *audited* by an independent public accountant and the accountant's audit report.

An *audit* provides a level of scrutiny by the accountant that is higher than a *review.*

The sharing of views by members of the *crowd* is considered by some to be an integral part of crowd-funding. Broker-dealers and funding portals, through their crowdfunding platforms, are required to have communication channels transparent to the public—for example, on an online forum—relating to each particular investment opportunity. In these channels, the *crowd* of investors can weigh in on the pros and cons of an opportunity and be able to ask the company questions. All persons representing the company must identify themselves. It may be worthwhile to monitor these communication channels before and after you make your commitment to invest.

Changing your mind. You have up to 48 hours prior to the end of the offer period to change your mind and cancel your investment commitment for any reason. ***Once the offering period is within 48 hours of ending, you will not be able to cancel for any reason even if you make your commitment during this period.*** However, if the company makes a material change to the offering terms or other information disclosed to you, you will be given five business days to reconfirm your investment commitment.

What's different about being a crowdfunding investor?

Being a crowdfunding investor is different than being a shareholder in a publicly listed company. For one thing, you cannot sell your shares at any time as you would be able to do if you held shares in a publicly listed company. In fact, ***you are restricted from reselling your shares for the first year***, unless the shares are transferred:

- to the company that issued the securities;
- to an accredited investor;
- to a *family member*;
- in connection with your death or divorce or other similar circumstance;
- to a trust controlled by you or a trust created for the benefit of a *family member*;
- as part of an offering registered with the SEC.

Family member. For purposes of the above, a family member is defined as a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships.

Another difference from being a shareholder of a publicly listed company is the amount of information you'll receive about your investment. Publicly listed companies generally are required to disclose information about their performances at least on a quarterly and annual basis and on a regular basis about material events that affect the company. ***In contrast, crowdfunding companies are only required to disclose annually their results of operations and financial statements.***

Additional Information

To learn more about crowdfunding, see the recently adopted rules.

For our Investment Adviser Public Disclosure (IAPD) website, visit adviserinfo.sec.gov.

For FINRA's BrokerCheck, visit brokercheck.finra.org.

For information on how to search for company documents in the SEC's EDGAR database, see Using EDGAR—Researching Public Companies.

For another resource for using EDGAR, see Researching Public Companies Through EDGAR: A Guide for Investors.

For more information about accredited investors, see our Investor Bulletin.

For additional investor educational information, see the SEC's website for individual investors, Investor.gov.